Tennessee Board of Regents
East Tennessee State University

For the Year Ended
June 30, 2003

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

February 24, 2004

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable Charles W. Manning, Chancellor
Tennessee Board of Regents
1415 Murfreesboro Road, Suite 350
Nashville, Tennessee 37217
and
Dr. Paul E. Stanton, President
East Tennessee State University
Campus Box 70734
Johnson City, Tennessee 37614-0002

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, East Tennessee State University, for the year ended June 30, 2003. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/sds
04/009

State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit
East Tennessee State University
For the Year Ended June 30, 2003

AUDIT OBJECTIVES

The objectives of the audit were to consider the university's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, contracts, and grants; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

The audit report contains no findings.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report, please contact

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Audit Report
Tennessee Board of Regents
East Tennessee State University
For the Year Ended June 30, 2003

TABLE OF CONTENTS

Tennessee Board of Regents
East Tennessee State University
For the Year Ended June 30, 2003

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee Board of Regents, East Tennessee State University. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to "perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller."

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

East Tennessee State University was established by an act of the General Assembly in 1909 as East Tennessee State Normal School. In 1924, the name was changed to East Tennessee State Teachers College; in 1930, to State Teachers College, Johnson City; and in 1943, to East Tennessee State College. In 1963, by an act of the General Assembly, East Tennessee College was granted university status, and its name was changed to East Tennessee State University.

The university has nine colleges and schools: College of Arts and Sciences, College of Business, College of Education, College of Public and Allied Health, School of Graduate Studies, School of Continuing Studies, College of Medicine, College of Applied Science and Technology, and College of Nursing. East Tennessee State University is officially authorized to grant 14 undergraduate and 22 graduate degrees.

ORGANIZATION

The governance of East Tennessee State University is vested in the Tennessee Board of Regents. The Governor, the Commissioner of Education, the Commissioner of Agriculture, and the Director of the Tennessee Higher Education Commission serve *ex officio* on this board. The chief administrative officer of the university is the president, who is assisted and advised by members of the faculty and administrative staff.

AUDIT SCOPE

The audit was limited to the period July 1, 2002, through June 30, 2003, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Financial statements are presented for the year ended June 30, 2003, and for comparative purposes, the year ended June 30, 2002. East Tennessee State University is an institution of the Tennessee Board of Regents, which is an integral part of state government. As such, the Tennessee Board of Regents has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report.*

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the university's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, contracts, and grants;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

Although this audit was not intended to serve as an organization-wide audit as described in the Single Audit Act, as amended by the Single Audit Act Amendments of 1996, and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, it included tests of compliance with applicable federal laws and regulations and consideration of internal control used in administering federal financial assistance programs. This audit is a segment of the organization-wide audit of the State of Tennessee, which is conducted in accordance with the Single Audit Act.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the university's financial statements for the year ended June 30, 2003, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the university's financial statements.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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PHONE (615) 401-7897
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Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

October 31, 2003

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the financial statements of East Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of and for the year ended June 30, 2003, and have issued our report thereon dated October 31, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the university's financial statements are free of material misstatement, we performed tests of the university's compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the university's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA,
Director

AAH/sds

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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Independent Auditor's Report

October 31, 2003

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying statements of net assets of East Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of June 30, 2003, and June 30, 2002, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the university's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee Board of Regents, East Tennessee State University, as of June 30, 2003, and June 30, 2002, and the revenues, expenses, and changes in net assets and the cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 13, during the year ended June 30, 2002, the university implemented GASB Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. The university also implemented GASB Statement 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus*, and GASB Statement 38, *Certain Financial Statement Note Disclosures*.

The management's discussion and analysis on pages 8 through 17 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 31, 2003, on our consideration of the university's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA,
Director

AAH/sds

Management's Discussion and Analysis

This section of East Tennessee State University's annual financial report presents a discussion and analysis of the financial performance of the university during the fiscal year ended June 30, 2003, with comparative information presented for the fiscal year ended June 30, 2002. This discussion has been prepared by management along with the financial statements and related note disclosures and should be read in conjunction with them. The financial statements, notes, and this discussion are the responsibility of management.

Using This Annual Report

This report consists of three basic financial statements. The statement of net assets; the statement of revenues, expenses, and changes in net assets; and the statement of cash flows provide information on East Tennessee State University as a whole and present a long-term view of the university's finances.

The Statement of Net Assets

The statement of net assets presents the financial position of the university at the end of the fiscal year and includes all assets and liabilities of the university. The difference between total assets and total liabilities—net assets—is an indicator of the current financial condition of the university. Assets and liabilities are generally measured using current values. One notable exception is capital assets, which are stated at historical cost less an allowance for depreciation.

Net assets are divided into three major categories. The first category, invested in capital assets, net of related debt, provides the university's equity in property, plant, and equipment owned by the university. The next asset category is restricted net assets, which is divided into two categories, nonexpendable and expendable. The corpus of nonexpendable restricted resources is only available for investment purposes. Expendable restricted net assets are available for expenditure by the university but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the assets. The final category is unrestricted net assets. Unrestricted net assets are available to the institution for any lawful purpose of the institution.

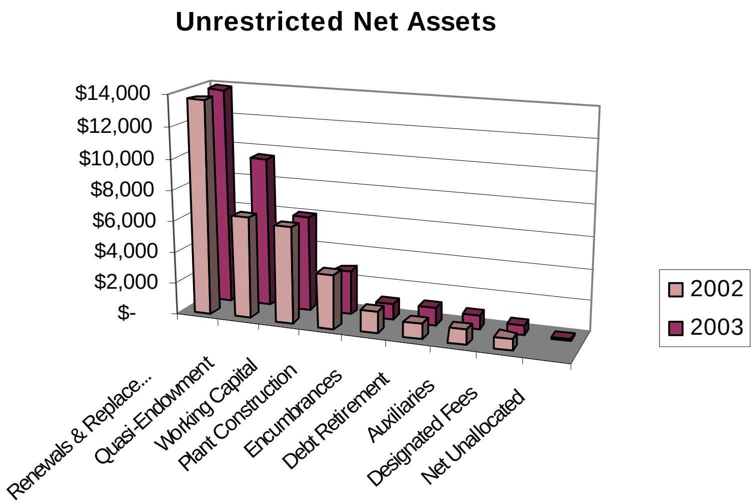
Statements of Net Assets
(in thousands of dollars)

	2003	2002
Assets:		
Current assets	$ 46,428	$ 42,415
Capital assets, net	150,913	154,411
Other assets	34,400	37,832
Total assets	231,741	234,658
Liabilities:		
Current liabilities	17,506	18,521
Noncurrent liabilities	40,946	40,439
Total liabilities	58,452	58,960
Net assets:		
Invested in capital assets, net of related debt	$ 123,106	$ 125,178
Restricted – expendable	14,086	16,446
Restricted – nonexpendable	39	39
Unrestricted	36,058	34,035
Total net assets	$ 173,289	$ 175,698

Material assets consist of cash and cash equivalents; accounts, notes, and grants receivable; and capital assets. Increases in current assets can be found in cash and cash equivalents as a result of freezes implemented by the institution in response to a 5% impoundment of state appropriations for FY 02-03 and a planned 9% reduction in state appropriations for FY 03-04. Net capital assets decreased due to the depreciation of assets with no significant capital asset additions. Other assets decreased during the year due to a reduction in noncurrent cash and cash equivalents.

Material liabilities include long-term bonded debt, compensated absences, and deferred revenue. For FY 02-03 the university changed its method of calculating the current portion of compensated absences. As a result, the current portion of compensated absences decreased significantly while increasing the noncurrent liability.

Many of the university's unrestricted net assets have been designated or reserved for specific purposes such as repairs and replacement of equipment, future debt service, quasi-endowments, and capital projects. The following graph shows the allocations. Amounts are shown in thousands of dollars.



The primary increase in unrestricted net assets occurred in the quasi-endowment category. This was due to an additional $3.5 million transfer from the College of Medicine to increase quasi-endowments that have been established for clinical services, research, and scholarships.

The Statement of Revenues, Expenses, and Changes in Net Assets

The statement of revenues, expenses, and changes in net assets presents the operating results of the university, as well as the nonoperating revenues and expenses. Annual state appropriations, while budgeted for operations, are considered nonoperating revenues according to generally accepted accounting principles.

Statements of Revenues, Expenses and Changes in Net Assets
(in thousands of dollars)

	2003	2002
Operating revenues:		
Net tuition and fees	$ 36,097	$ 32,832
Grants and contracts	42,408	35,803
Auxiliary enterprises	7,411	7,238
Other	18,127	17,776
Total operating revenues	104,043	93,649
Operating expenses	203,692	199,302
Operating loss	(99,649)	(105,653)
Nonoperating revenues and expenses:		
State appropriations	80,791	79,011
Gifts	6,328	13,659
Investment income	1,715	2,515
Other revenues and expenses	6,651	6,670
Total nonoperating revenues and expenses	95,485	101,855
Income (loss) before other revenues, expenses, gains, or losses	(4,164)	(3,798)
Other revenues, expenses, gains, or losses:		
Capital appropriations	1,587	1,905
Capital grants and gifts	168	35,471
Other	-	(50)
Total other revenues, expenses, gains, or losses	1,755	37,326
Increase (decrease) in net assets	(2,409)	33,528
Net assets at beginning of year	175,698	284,250
Cumulative effects of changes in accounting principle	-	(142,080)
Net assets at beginning of period, restated	175,698	142,170
Net assets at end of year	$ 173,289	$ 175,698

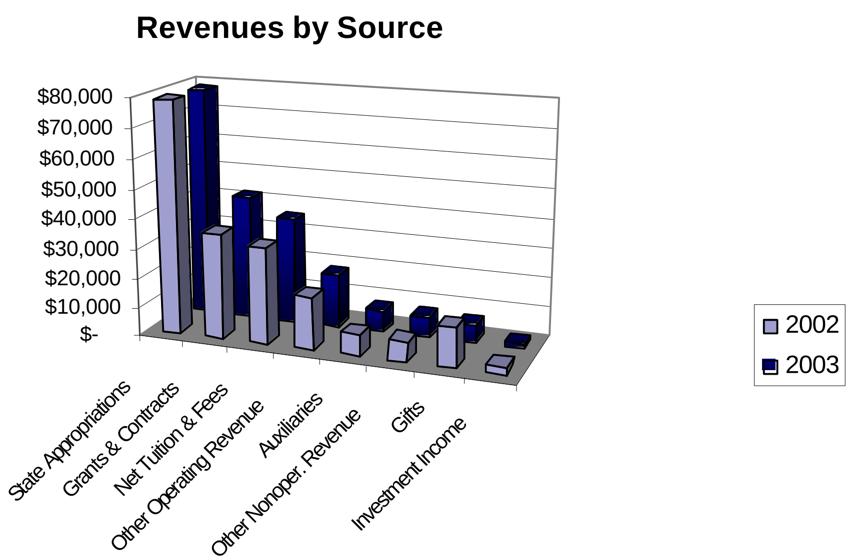
The increase in tuition and fees is primarily due to a 7.5% increase in fees for the 2003 academic year. Operating grants and contracts increased by $6,605,000 due to a general increase in grants and contracts. The largest increases were in grants from the U.S. Department of Health and Human Services and the U.S. Department of Education, and Medical Education Assistance Corporation hospital contracts.

In fiscal years 2002 and 2003, nonoperating gifts included software donated to the Digital Media Center valued at $9,900,000 and $1,825,000, respectively. Investment income decreased due to the continuing economic downturn.

Capital grants and gifts for 2002 included gifts of capital assets from the federal government and the State of Tennessee totaling $34,735,000.

Revenues

The following is a graphic illustration of revenues by source (both operating and nonoperating), which were used to fund the university's operating activities for the year ended June 30, 2003, and the year ended June 30, 2002. Amounts are presented in thousands of dollars.



For fiscal year 2003, 79% of ETSU's revenue used to fund operating activities is attributed to state appropriations, grants and contracts, and tuition and fees.

Expenses

Operating expenses can be displayed in two formats, natural classification and functional classification. Both formats are displayed below (in thousands of dollars).

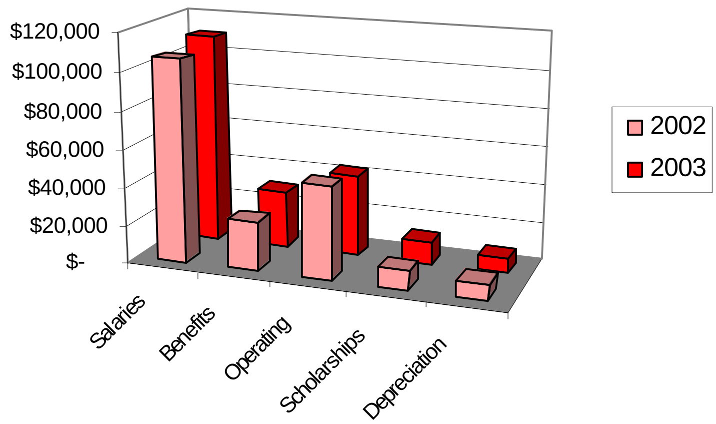
2003 Natural Classification

2003 Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$ 66,465	$ 16,445	$ 13,430	$ 1,590	$ -	$ 97,930
Research	6,593	2,001	4,554	46	-	13,194
Public service	6,039	1,547	3,406	43	-	11,035
Academic support	9,512	2,670	4,114	375	-	16,671
Student services	6,481	2,048	3,745	1,289	-	13,563
Institutional support	9,222	3,029	371	165	-	12,787
Operation and maintenance of plant	5,230	2,126	8,193	1	-	15,550
Scholarships	1	8	403	8,170	-	8,582
Auxiliaries	1,276	288	4,539	86	-	6,189
Depreciation	-	-	-	-	8,191	8,191
Total expenses	$ 110,819	$ 30,162	$ 42,755	$ 11,765	$ 8,191	$ 203,692

2002 Natural Classification

2002 Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$ 63,334	$ 14,005	$ 22,016	$ 1,272	$ -	$ 100,627
Research	6,359	1,682	3,935	62	-	12,038
Public service	5,603	1,348	3,323	72	-	10,346
Academic support	9,602	2,429	3,466	365	-	15,862
Student services	6,286	1,812	3,523	1,406	-	13,027
Institutional support	8,953	2,638	878	183	-	12,652
Operation and maintenance of plant	4,986	1,754	7,300	2	-	14,042
Scholarships	3	12	327	6,399	-	6,741
Auxiliaries	1,149	261	3,998	165	-	5,573
Depreciation	-	-	-	-	8,394	8,394
Total expenses	$ 106,275	$ 25,941	$ 48,766	$ 9,926	$ 8,394	$ 199,302

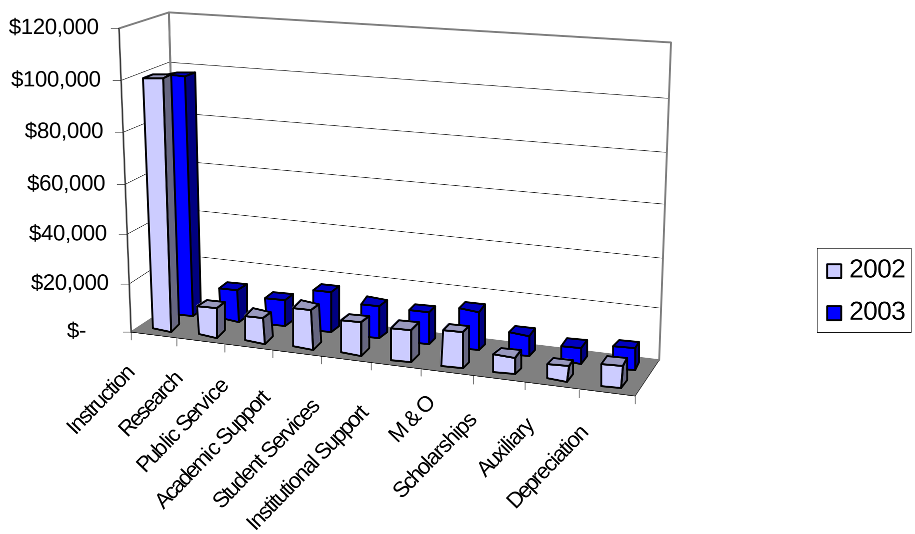
Operating Expenses by Natural Classification



Salaries increased due to a 2% pay raise implemented in FY 02-03 as well as implementation of the second step of the university pay plan. Employee benefit expenses increased due to increases in medical insurance, state retirement, and unemployment compensation. Other operating expenses decreased due to a freeze of expenses implemented as a result of a 5% impoundment of state appropriations for FY 02-03 and a 9% base state appropriation reduction for FY 03-04.

For fiscal year 2003, 69% of operating expenses are attributed to salaries and benefits. Other operating expenses represent 21% of total operating expenses with scholarships and depreciation representing the remaining ten percent of expenses.

Operating Expenses by Functional Classification



There were no material changes in expenses by functional classification.

For fiscal year 2003, 48% of operating expenses by function is attributable to instruction. The percentages for the remaining functional areas range from 3% to 8% of total operating expenses.

The Statement of Cash Flows

The statement of cash flows provides information about cash receipts and cash payments during the year. This statement also assists users in assessing the university's ability to generate net cash flows, its ability to meet its obligations as they come due, and its need for external financing.

Statements of Cash Flows
(in thousands of dollars)

	2003	2002
Cash provided (used) by:		
Operating activities	$ (89,852)	$ (85,959)
Noncapital financing activities	93,889	89,444
Capital and related financing activities	(6,671)	(6,016)
Investing activities	2,119	2,568
Net increase (decrease) in cash	$ (515)	$ 37
Cash, beginning of year	54,193	54,156
Cash, end of year	$ 53,678	$ 54,193

Material sources of cash included state appropriations, tuition and fees, and grants and contracts. Material uses of cash were for payments to suppliers and vendors, payments to employees, and payments for scholarships and fellowships. Cash used by operating activities increased due to salary and benefit increases. Cash provided by noncapital financing activities increased due to an overall increase in state appropriations. Cash used by capital and related financing activities increased due to an overall reduction of proceeds from capital debt and a resulting decrease in expenses as several projects were completed during the 2003 fiscal year. Finally cash provided by investing activities decreased due to a reduction in investment income because of decreasing interest rates.

The cash position of the university decreased by $515,000 during the fiscal year ended June 30, 2003.

Capital Asset and Debt Administration

Capital Assets

At June 30, 2003, East Tennessee State University had $150,912,000 invested in capital assets, net of accumulated depreciation. Depreciation charges totaled $8,191,000 for the current fiscal year. Details of these assets are shown below.

Schedule of Capital Assets, Net of Depreciation
(in thousands of dollars)

	2003	2002
Land	$ 23,486	$ 22,645
Land improvements & infrastructure	10,142	10,475
Buildings	101,229	105,404
Equipment	7,082	7,116
Library holdings	7,882	8,327
Projects in progress	1,091	444
Total	$ 150,912	$ 154,411

Land increased due to the purchase of nine acres of land adjacent to the university. All remaining depreciable categories decreased due to the recording of depreciation with no significant additions to capital assets.

The university expects to make major capital expenditures during FY 2003-04 to continue a planned upgrade to electrical and steam line distribution systems funded from state appropriations as well as beginning construction of a new student apartment complex that is being funded from the issuance of TSSBA bonds.

More detailed information about the university's capital assets is presented in Note 6 to the financial statements.

Debt

At June 30, 2003, the university had $27,806,000 in debt outstanding. The table below summarizes these amounts by type of debt instrument.

Outstanding Debt Schedule
(in thousands of dollars)

	2003	2002
Notes	$ 450	$ 500
Loans	2,261	2,354
Bonds	25,095	26,379
Total Debt	$ 27,806	$ 29,233

The decrease in total debt was the result of payment of principal with no new debt added during the year.

The Tennessee State School Bond Authority (TSSBA) must authorize all capital long-term debt on behalf of the university. TSSBA currently is rated as AA- by Standard & Poor. More detailed information about the university's long-term liabilities is presented in Note 8 to the financial statements.

Economic Factors That Will Affect the Future

As with most states, the State of Tennessee has been faced with significant budget reductions due to the current negative economic climate. The state appropriation to the university has been reduced by $7,480,400 for FY 03-04 or 9%. This is considered a permanent base budget reduction. In partial response, the Tennessee Board of Regents authorized a 14% fee increase that is expected to offset approximately $4,000,000 of the reduction. Additionally, the university undertook an extensive review of its operations so that required reductions would be made in a strategic manner to maintain the core mission of educating citizens of Tennessee. The university has completed this process and is moving forward in meeting its vision to be the university of choice in the state and region.

We are not aware of any other factors, decisions, or conditions that are expected to have a significant impact on the university's financial position or results of operations during the upcoming fiscal year.

Requests for Information

This financial report is designed to provide a general overview of the university's finances for all those with an interest in the university's finances. Questions concerning any of the information provided in this report or requests for additional information should be directed to Dr. David Collins, Vice President for Business and Finance, P. O. Box 70601, Johnson City, Tennessee 37604.

Exhibit A

EAST TENNESSEE STATE UNIVERSITY
STATEMENTS OF NET ASSETS
JUNE 30, 2003, AND JUNE 30, 2002

	June 30, 2003	June 30, 2002
ASSETS		
Current assets:		
Cash and cash equivalents (Notes 2 and 3)	$ 28,295,517.93	$ 25,093,873.36
Short-term investments (Notes 3 and 4)	2,010,000.00	2,010,000.00
Accounts, notes, and grants receivable (net) (Note 5)	14,793,532.26	14,094,550.98
Inventories (at lower of cost or market)	647,236.55	651,344.06
Prepaid expenses and deferred charges	310,900.73	189,279.95
Accrued interest receivable	359,180.02	363,531.37
Other assets	12,131.70	12,746.00
Total current assets	46,428,499.19	42,415,325.72
Noncurrent assets:		
Cash and cash equivalents (Notes 2 and 3)	25,382,129.42	29,099,019.35
Accounts, notes, and grants receivable (net) (Note 5)	8,658,713.45	8,443,237.46
Prepaid expenses and deferred charges	-	56,729.84
Capital assets (net) (Note 6)	150,912,769.99	154,411,263.91
Other assets	359,090.72	232,470.85
Total noncurrent assets	185,312,703.58	192,242,721.41
Total assets	231,741,202.77	234,658,047.13
LIABILITIES		
Current liabilities:		
Accounts payable	2,846,099.13	2,606,136.86
Accrued liabilities	5,122,541.81	4,809,826.89
Student deposits	386,414.57	380,657.07
Deferred revenue	5,574,168.11	5,676,183.37
Compensated absences (Note 8)	976,396.21	2,450,131.39
Accrued interest payable	288,373.62	354,164.70
Long-term liabilities, current portion (Note 8)	1,515,470.67	1,426,244.24
Deposits held in custody for others	796,749.89	813,779.09
Other liabilities	-	3,583.40
Total current liabilities	17,506,214.01	18,520,707.01
Noncurrent liabilities:		
Compensated absences (Note 8)	7,331,189.65	5,361,293.04
Long-term liabilities (Note 8)	26,291,239.98	27,806,494.47
Due to grantors (Note 8)	7,323,205.36	7,271,158.41
Total noncurrent liabilities	40,945,634.99	40,438,945.92
Total liabilities	58,451,849.00	58,959,652.93
NET ASSETS		
Invested in capital assets, net of related debt	123,106,059.34	125,178,525.20
Restricted for:		
Nonexpendable:		
Scholarships and fellowships	39,153.12	39,084.76
Expendable:		
Scholarships and fellowships	43,760.15	26,001.41
Research	625,275.58	479,463.69
Instructional department uses	7,883,638.58	10,883,869.12
Loans	1,888,686.62	1,834,752.76
Debt service	2,665,227.18	2,146,837.10
Other	979,711.04	1,074,424.69
Unrestricted (Note 9)	36,057,842.16	34,035,435.47
Total net assets	$ 173,289,353.77	$ 175,698,394.20

The notes to the financial statements are an integral part of this statement.

Exhibit B

EAST TENNESSEE STATE UNIVERSITY
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002

	Year Ended June 30, 2003	Year Ended June 30, 2002
REVENUES		
Operating revenues:		
Student tuition and fees (net of scholarship allowances of $10,183,103.55 for the year ended June 30, 2003, and $9,956,818.74 for the year ended June 30, 2002)	$ 36,097,296.45	$ 32,831,492.69
Governmental grants and contracts	34,933,989.56	28,952,481.78
Non-governmental grants and contracts	7,473,848.23	6,850,647.24
Sales and services of educational departments	16,425,418.73	15,850,281.67
Auxiliary enterprises:		
Residential life (net of scholarship allowances of $109,599.19 for the year ended June 30, 2003, and $109,839.84 for the year ended June 30, 2002; all residential life revenues are used as security for revenue bonds; see Note 8)	5,254,338.88	5,148,192.28
Bookstore	385,413.02	338,953.56
Food service	375,946.62	398,275.35
Center for physical activities (all revenues are used as security for revenue bonds; see Note 8)	832,092.32	778,810.09
Other auxiliaries	563,654.10	573,488.24
Interest earned on loans to students	155,052.11	168,318.83
Other operating revenues	1,546,152.89	1,757,658.55
Total operating revenues	104,043,202.91	93,648,600.28
EXPENSES		
Operating expenses (Note 18):		
Salaries and wages	110,818,547.45	106,275,306.35
Benefits	30,162,078.71	25,940,555.48
Utilities, supplies, and other services	42,754,901.10	48,765,991.64
Scholarships and fellowships	11,764,757.37	9,925,390.25
Depreciation expense	8,191,364.67	8,394,471.26
Total operating expenses	203,691,649.30	199,301,714.98
Operating loss	(99,648,446.39)	(105,653,114.70)
NONOPERATING REVENUES (EXPENSES)		
State appropriations	80,790,697.05	79,010,600.00
Gifts	6,328,001.11	13,659,093.24
Grants and contracts	8,543,101.61	8,340,854.35
Investment income	1,715,472.70	2,515,255.48
Interest on capital asset-related debt	(1,488,081.26)	(1,126,239.08)
Bond issuance costs	-	(177,128.35)
Other nonoperating expenses	(405,067.98)	(366,963.00)
Net nonoperating revenues	95,484,123.23	101,855,472.64
Loss before other revenues, expenses, gains, or losses	(4,164,323.16)	(3,797,642.06)
Capital appropriations	1,587,156.71	1,904,851.60
Capital grants and gifts	168,126.02	35,471,200.42
Other	-	(50,390.79)
Total other revenues	1,755,282.73	37,325,661.23
Increase (decrease) in net assets	(2,409,040.43)	33,528,019.17
NET ASSETS		
Net assets - beginning of year	175,698,394.20	284,249,754.96
Cumulative effects of changes in accounting principle (Note 13)		
Adoption of capitalization criteria for buildings and additions	-	(4,571,227.64)
Change in method of capitalizing library holdings	-	(37,490,305.35)
Adoption of depreciation on capital assets	-	(93,905,211.24)
Deferred revenue recognition	-	1,020,193.48
Reclassification of U.S. government grants refundable	-	(7,132,829.18)
Net assets - beginning of year, as restated	175,698,394.20	142,170,375.03
Net assets - end of year	$ 173,289,353.77	$ 175,698,394.20

The notes to the financial statements are an integral part of this statement.

Exhibit C

EAST TENNESSEE STATE UNIVERSITY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002

	Year Ended June 30, 2003	Year Ended June 30, 2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	$ 36,104,199.76	$ 31,679,036.87
Grants and contracts	41,204,891.17	35,214,217.74
Sales and services of educational activities	16,086,820.20	15,776,788.49
Payments to suppliers and vendors	(40,229,578.86)	(38,075,123.72)
Payments to employees	(110,301,890.05)	(104,863,721.69)
Payments for benefits	(29,885,848.53)	(25,357,661.52)
Payments for scholarships and fellowships	(11,758,271.63)	(9,550,653.77)
Loans issued to students and employees	(2,603,675.95)	(2,033,697.54)
Collection of loans from students and employees	2,371,892.26	2,100,010.84
Interest earned on loans to students	161,495.66	154,344.61
Auxiliary enterprise charges:		
Residence halls	5,231,114.67	5,141,353.19
Bookstore	413,942.05	354,799.37
Food services	373,390.99	398,296.23
Center for physical activities	832,092.32	778,810.09
Other auxiliaries	549,204.12	566,146.59
Other receipts (payments)	1,598,199.84	1,757,658.55
Net cash provided (used) by operating activities	(89,852,021.98)	(85,959,395.67)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	81,427,697.05	78,182,400.00
Net cash balance implicitly financed (repaid)	-	(734,365.45)
Gifts and grants received for other than capital or endowment purposes	12,478,554.83	11,608,133.89
Federal student loan receipts	30,809,008.30	29,947,397.88
Federal student loan disbursements	(30,778,458.74)	(29,893,408.49)
Changes in deposits held for others	(47,578.76)	334,131.77
Net cash provided (used) by noncapital financing activities	93,889,222.68	89,444,289.60
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital debt	-	13,396,828.35
Capital appropriations	1,587,156.71	1,904,851.60
Capital grants and gifts received	85,204.24	123,040.12
Purchases of capital assets and construction	(5,015,016.95)	(10,743,413.76)
Principal paid on capital debt and leases	(1,426,028.06)	(9,019,038.74)
Interest paid on capital debt and leases	(1,553,872.34)	(1,035,392.54)
Bond issue costs paid on new debt issue	-	(177,128.35)
Deposit with trustee	56,729.84	(21,341.89)
Other capital and related financing receipts (payments)	(405,067.98)	(444,049.79)
Net cash provided (used) by capital and related financing activities	(6,670,894.54)	(6,015,645.00)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	2,010,000.00	2,010,000.00
Income on investments	2,118,448.48	2,567,956.26
Purchases of investments	(2,010,000.00)	(2,010,000.00)
Net cash provided (used) by investing activities	2,118,448.48	2,567,956.26
Net increase (decrease) in cash and cash equivalents	(515,245.36)	37,205.19
Cash and cash equivalents - beginning of year	54,192,892.71	54,155,687.52
Cash and cash equivalents - end of year	$ 53,677,647.35	$ 54,192,892.71

EAST TENNESSEE STATE UNIVERSITY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002

	Year Ended June 30, 2003	Year Ended June 30, 2002
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$ (99,648,446.39)	$ (105,653,114.70)
Adjustments to reconcile operating loss to net cash provided (used) by operating activities:		
Depreciation expense	8,191,364.67	8,394,471.26
ETSU Foundation expenses on behalf of university	2,392,547.89	10,391,813.70
Change in assets and liabilities:		
Receivables, net	(1,319,673.58)	(3,028,834.54)
Inventories	4,107.51	35,333.38
Prepaid expenses and deferred charges	(121,620.78)	475,752.12
Accrued interest receivable	6,443.55	(22,711.13)
Other assets	(126,005.57)	121,599.61
Accounts payable	239,962.27	56,995.47
Accrued liabilities	309,131.52	1,469,840.88
Deferred revenue	(102,015.26)	998,111.47
Deposits	5,757.50	61,555.49
Compensated absences	496,161.43	535,148.79
Due to grantors	52,046.95	138,329.23
Loans to students and employees	(231,783.69)	66,313.30
Net cash used by operating activities	$ (89,852,021.98)	$ (85,959,395.67)

Non-Cash Transactions

Expenditures by ETSU Foundation on behalf of the university	$2,392,547.89	$10,391,813.70
Gifts of capital assets to the university	$82,921.78	$35,755,143.30

The notes to the financial statements are an integral part of this statement.

Tennessee Board of Regents
East Tennessee State University
Notes to the Financial Statements
June 30, 2003, and June 30, 2002

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The university is a part of the State University and Community College System of Tennessee (Tennessee Board of Regents). This system is a component unit of the State of Tennessee because the state appoints a majority of the system's governing body and provides financial support; the system is discretely presented in the *Tennessee Comprehensive Annual Financial Report*.

Basis of Presentation

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). In June 1999, the GASB issued Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. This was followed in November 1999 by GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. The financial presentation required by those statements provides a comprehensive, entity-wide perspective of the university's assets, liabilities, net assets, revenues, expenses, changes in net assets, and cash flows, and replaces the fund-group perspective previously required.

Significant accounting changes made in order to comply with the new requirements include (1) adoption of depreciation on capital assets and (2) reporting summer school revenues and expenses between fiscal years rather than in one fiscal year.

Basis of Accounting

For financial statement purposes, the university is considered a special-purpose government engaged only in business-type activities. Accordingly, the financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. All significant interfund transactions have been eliminated.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The university has the option of following private-sector guidance issued subsequent to November 30, 1989, subject to the above limitation. The university has elected not to follow private-sector guidance issued subsequent to November 30, 1989.

Amounts reported as operating revenues include (1) tuition and fees, net of waivers and discounts; (2) federal, state, local, and private grants and contracts; (3) sales and services of auxiliary enterprises; and (4) other sources of revenue. Operating expenses for the university include (1) salaries and wages; (2) employee benefits; (3) scholarships and fellowships; (4) depreciation; and (5) utilities, supplies, and other services.

All other activity is nonoperating in nature and includes (1) state appropriations for operations; (2) investment income; (3) bond issuance costs; (4) interest on capital asset-related debt; and (5) nonoperating gifts and grants.

When both restricted and unrestricted resources are available for use, generally it is the university's policy to use the restricted resources first.

Inventories

Inventories are valued at the lower of cost or market. Items are maintained on an average cost or first-in, first-out basis.

Compensated Absences

The university's employees accrue annual leave at varying rates, depending on length of service or classification. Some employees also earn compensatory time. The amount of these liabilities and their related benefits are reported in the statement of net assets.

Capital Assets

Capital assets, which include property, plant, equipment, and library holdings, are reported in the statement of net assets at historical cost or at fair value at date of donation, less accumulated depreciation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's useful life are not capitalized.

A capitalization threshold of $100,000 is used for buildings, and $50,000 is used for infrastructure. Equipment is capitalized when the unit acquisition cost is $5,000 or greater. The capitalization threshold for additions and improvements to buildings and land is set at $50,000.

These assets, with the exception of land, are depreciated using the straight-line method over the estimated useful lives, which range from 5 to 40 years.

Net Assets

The university's net assets are classified as follows:

Invested in capital assets, net of related debt – This represents the university's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

Nonexpendable restricted net assets – Nonexpendable restricted net assets consist of endowment and similar type funds in which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may be expendable or added to principal.

Expendable restricted net assets – Expendable restricted net assets include resources which the university is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

Unrestricted net assets – Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, and sales and services of educational departments and auxiliary enterprises. These resources are used for transactions relating to the educational and general operations of the university, and may be used at the discretion of the university to meet current expenses for any purpose. The auxiliary enterprises are substantially self-supporting activities that provide services for students, faculty, and staff.

Scholarship Discounts and Allowances

Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the statement of revenues, expenses, and changes in net assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the university and the amount that is paid by the student and/or third parties making payments on the student's behalf. Certain governmental grants, such as Pell grants, and other federal, state, or nongovernmental programs, are recorded as either operating or nonoperating revenues in the university's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the university has recorded a scholarship discount and allowance.

NOTE 2. CASH AND CASH EQUIVALENTS

In addition to demand deposits and petty cash on hand, this classification includes instruments which are readily convertible to known amounts of cash and which have original maturities of three months or less. At June 30, 2003, cash and cash equivalents consisted of $1,725,519.94 in bank accounts, $30,000.00 of petty cash on hand, $50,250,247.05 in the State of Tennessee Local Government Investment Pool (LGIP) administered by the State Treasurer, $132,880.36 in LGIP deposits for capital projects, and $1,539,000.00 in overnight repurchase agreements. At June 30, 2002, cash and cash equivalents consisted of $394,839.66 in bank accounts, $30,000.00 of petty cash on hand, $47,293,953.37 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, $674,099.68 in LGIP deposits for capital projects, and $5,800,000.00 in overnight repurchase agreements.

LGIP deposits for capital projects - Payments related to the university's capital projects are made by the State of Tennessee's Department of Finance and Administration. The university's estimated local share of the cost of each project is held in a separate Local Government Investment Pool (LGIP) account. As expenses are incurred, funds are withdrawn from the LGIP account by the Tennessee Board of Regents and transferred to the Department of Finance and Administration. The funds in the account are not available to the university for any other purpose until the project is completed and the Tennessee Board of Regents releases any remaining funds.

NOTE 3. DEPOSITS

The university's deposits are in financial institutions that participate in the bank collateral pool administered by the State Treasurer. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure. In addition, the university has one account which is entirely covered by FDIC (Federal Deposit Insurance Corporation) insurance.

The laws of the State of Tennessee require that collateral be pledged to secure all uninsured deposits. Tennessee Board of Regents policies require that the market value of collateral pledged equal 115%, 100%, or 90% of the uninsured deposits at financial institutions participating in the collateral pool. The pledge level is based on financial criteria set by the Collateral Pool Board with the financially strongest institutions being eligible for the lowest pledge level.

The university also has deposits in the Local Government Investment Pool (LGIP) administered by the State Treasurer. The LGIP is part of the Pooled Investment Fund. The fund's investment policy and custodial credit risk are presented in the *Tennessee Comprehensive Annual Financial Report.* That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

NOTE 4. INVESTMENTS

The university is authorized by statute to invest funds in accordance with Tennessee Board of Regents policies. Under the current policy, funds other than endowments may be invested only in obligations of the United States or its agencies backed by the full faith and credit of the United States; repurchase agreements for United States securities; certificates of deposit in banks and savings and loan associations; bankers' acceptances; commercial paper; money market mutual funds; and the State of Tennessee Local Government Investment Pool. The policy requires that investments of endowments in equity securities be limited to funds from private gifts or other sources external to the university and that endowment investments be prudently diversified. Investments are valued at fair value.

The university's investments at June 30, 2003, and June 30, 2002, consisted of certificates of deposit with original maturities greater than three months. These have been included with other deposits in Note 3 to determine the adequacy of collateral security pledged.

Excess balances in the university's operating account, a "sweep" account, were automatically invested in overnight repurchase agreements during the years ended June 30, 2003, and June 30, 2002. The college had $1,539,000 invested in overnight repurchase agreements at June 30, 2003, and $5,800,000 invested in overnight repurchase agreements at June 30, 2002. These amounts are classified as cash and cash equivalents on the university's statements of net assets. The market value of the securities underlying the repurchase agreements at June 30, 2003, was $1,539,000, and at June 30, 2002, was $5,800,000.

Investments of this type are categorized to indicate the level of risk assumed by the university. Category 1 consists of insured or registered investments or investments for which the securities are held by the university or its agent in the university's name. Category 2 consists of uninsured or unregistered investments for which the securities are held by the counterparty's trust department or agent in the university's name. Category 3 consists of uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department or agent but not in the university's name.

The university's investments in overnight repurchase agreements at June 30, 2003, and June 30, 2002, are reported as category 1. These amounts are insured via the bank collateral pool administered by the state treasurer.

NOTE 5. RECEIVABLES

Receivables included the following:

	June 30, 2003	June 30, 2002
Student accounts receivable	$4,629,315.76	$4,199,777.16
Grants receivable	8,006,806.19	7,299,128.70
Notes receivable	521,979.85	540,671.75
State appropriation receivable	191,200.00	-
Other receivables	3,555,267.56	4,782,361.11
Subtotal	16,904,569.36	16,821,938.72
Less allowance for doubtful accounts	1,444,357.67	2,023,226.45
Total receivables	$15,460,211.69	$14,798,712.27

Federal Perkins Loan Program funds included the following:

	June 30, 2003	June 30, 2002
Perkins loans receivable	$9,107,484.45	$8,837,137.76
Less allowance for doubtful accounts	1,115,450.43	1,098,061.59
Total	$7,992,034.02	$7,739,076.17

NOTE 6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2003, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$22,645,164.24	$25,000.00	$871,137.50	$55,000.00	$23,486,301.74
Buildings	174,634,172.77	-	194,124.00	427,367.63	174,400,929.14
Land improvements and infrastructure	15,084,531.43	-	401,055.32	-	15,485,586.75
Equipment	24,589,575.34	1,653,486.30	-	1,268,554.10	24,974,507.54
Library holdings	16,202,344.02	1,306,194.96	-	1,461,326.49	16,047,212.49
Projects in progress	444,102.80	2,113,257.47	(1,466,316.82)	-	1,091,043.45
Total	253,599,890.60	5,097,938.73	-	3,212,248.22	255,485,581.11

Less accumulated depreciation:					
Buildings	69,230,197.32	4,166,431.37	-	224,368.18	73,172,260.51
Land improvements and infrastructure	4,609,683.52	733,863.06	-	-	5,343,546.58
Equipment	17,473,370.50	1,540,216.33	-	1,121,485.57	17,892,101.26
Library holdings	7,875,375.35	1,750,853.91	-	1,461,326.49	8,164,902.77
Total accum. depreciation	99,188,626.69	8,191,364.67	-	2,807,180.24	104,572,811.12
Capital assets, net	$154,411,263.91	$(3,093,425.94)	$ -	$405,067.98	$150,912,769.99

Capital asset activity for year ended June 30, 2002, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$4,643,209.24	$18,000,000.00	$1,955.00	$ -	$22,645,164.24
Buildings	124,388,365.02	16,978,307.16	33,267,500.59	-	174,634,172.77
Land improvements and infrastructure	10,150,942.79	283,748.80	4,649,839.84	-	15,084,531.43
Equipment	24,748,032.27	1,709,004.77	-	1,867,461.70	24,589,575.34
Library holdings	16,525,605.63	1,377,706.29	-	1,700,967.90	16,202,344.02
Projects in progress	30,186,912.19	8,176,486.04	(37,919,295.43)	-	444,102.80
Total	210,643,067.14	46,525,253.06	-	3,568,429.60	253,599,890.60
Less accumulated depreciation:					
Buildings	64,990,776.81	4,239,420.51	-	-	69,230,197.32
Land improvements and infrastructure	3,879,033.39	730,650.13	-	-	4,609,683.52
Equipment	17,249,388.99	2,041,052.42	-	1,817,070.91	17,473,370.50
Library holdings	7,786,012.05	1,790,331.20	-	1,700,967.90	7,875,375.35
Total accum. depreciation	93,905,211.24	8,801,454.26	-	3,518,038.81	99,188,626.69
Capital assets, net	$116,737,855.90	$37,723,798.80	$ -	$ 50,390.79	$154,411,263.91

NOTE 7. CAPITAL LEASE

The university has entered into an Enhanced Use Lease Agreement with the United States Department of Veteran's Affairs for certain real property and buildings at the Veteran's Affairs Medical Center in Johnson City, Tennessee. The lease is for a period of 35 years. In lieu of lease payments, the university has assumed responsibility for all capital and recurring costs of maintaining the property covered by the agreement.

In conjunction with the lease, the university entered into a memorandum of agreement with the Department of Veteran's Affairs to construct a new building (the Basic Science Building) with joint funding from the State of Tennessee and the federal government. In accordance with the memorandum of agreement, the state provided $18 million to the federal government for its share of the total construction costs ($34,195,153.41.) The Basic Science Building is included under the provisions of the Enhanced Use Lease Agreement.

The university's leasing of the Basic Science Building will constitute a capital lease agreement. The lease term is substantially equal to the estimated useful life of the leased property. Accordingly, the university has capitalized the cost of the building at $34,195,153.41.

NOTE 8. LONG-TERM LIABILITIES

Long-term liabilities activity for the year ended June 30, 2003, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
Notes	$500,000.00	$ -	$50,000.00	$450,000.00	$50,000.00
Loans	2,354,082.24	-	92,602.88	2,261,479.36	99,223.94
Bonds	26,378,656.47	-	1,283,425.18	25,095,231.29	1,366,246.73
Subtotal	29,232,738.71	-	1,426,028.06	27,806,710.65	1,515,470.67
Other liabilities:					
Compensated absences	7,811,424.43	4,999,013.92	4,502,852.49	8,307,585.86	976,396.21
Due to grantors	7,271,158.41	52,046.95	-	7,323,205.36	-
Subtotal	15,082,582.84	5,051,060.87	4,502,852.49	15,630,791.22	976,396.21
Total long-term liabilities	$44,315,321.55	$5,051,060.87	$5,928,880.55	$43,437,501.87	$2,491,866.88

Long-term liabilities activity for the year ended June 30, 2002, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
Notes	$ -	$500,000.00	$ -	$500,000.00	$50,000.00
Loans	2,440,505.79	-	86,423.55	2,354,082.24	92,602.88
Bonds	14,479,920.30	12,896,828.35	998,092.18	26,378,656.47	1,283,641.36
Commercial paper	7,934,523.01	-	7,934,523.01	-	-
Subtotal	24,854,949.10	13,396,828.35	9,019,038.74	29,232,738.71	1,426,244.24
Other liabilities:					
Compensated absences	7,276,275.64	4,716,527.94	4,181,379.15	7,811,424.43	2,450,131.39
Due to grantors	7,132,829.18	138,329.23	-	7,271,158.41	-
Subtotal	14,409,104.82	4,854,857.17	4,181,379.15	15,082,582.84	2,450,131.39
Total long-term liabilities	$39,264,053.92	$18,251,685.52	$13,200,417.89	$44,315,321.55	$3,876,375.63

Notes Payable

The Tennessee Board of Regents, on behalf of the university, borrowed funds for the renovation of the Memorial Athletic Medical Center. The note bears an annually adjusted interest rate equal to the average Local Government Investment Pool rate for the previous year, a face amount of $500,000.00, a minimum annual debt service of $50,000.00 plus interest, with payments due annually to 2012. The balance owed by the university was $450,000.00 at June 30, 2003, and $500,000.00 at June 30, 2002.

Debt service requirements to maturity for notes payable at June 30, 2003, are as follows:

Year Ending June 30	Principal	Interest	Total
2004	$ 50,000.00	$ 10,620.00	$ 60,620.00
2005	50,000.00	9,440.00	59,440.00
2006	50,000.00	8,260.00	58,260.00
2007	50,000.00	7,080.00	57,080.00
2008	50,000.00	5,900.00	55,900.00
2009 – 2012	200,000.00	11,800.00	211,800.00
	$450,000.00	$53,100.00	$503,100.00

Loans Payable

The Tennessee Board of Regents, on behalf of the university, borrowed funds for the construction of the East Tennessee State University Clinical Education Facility. The loan bears an interest rate of 7.15%, has a principal amount of $3,000,000.00, a minimum annual debt service of $260,919.72, and a due date of January 1, 2017. The balance owed by the university was $2,261,479.36 at June 30, 2003, and $2,354,082.24 at June 30, 2002.

Debt service requirements to maturity for loans payable at June 30, 2003, are as follows:

Year Ending June 30	Principal	Interest	Total
2004	$99,223.94	$161,695.78	$260,919.72
2005	106,318.45	154,601.27	260,919.72
2006	113,920.22	146,999.50	260,919.72
2007	122,065.51	138,854.21	260,919.72
2008	130,793.20	130,126.53	260,919.73
2009 – 2013	808,352.52	496,246.13	1,304,598.65
2014 – 2017	880,805.52	162,873.20	1,043,678.72
	$2,261,479.36	$1,391,396.62	$3,652,875.98

Bonds Payable

Bond issues, with interest rates ranging from 3.0% to 5.5% for Tennessee State School Bond Authority bonds, are due serially to 2032 and are secured by pledges of the facilities' revenues to which they relate and certain other revenues and fees of the university, including state appropriations. The bonded indebtedness with the Tennessee State School Bond Authority reported on the statement of net assets is shown net of assets held by the authority in the debt service reserve. The reserve amount was $76,932.56 at June 30, 2003, and $77,149.75 at June 30, 2002.

Debt service requirements to maturity for bonds payable at June 30, 2003, are as follows:

Year Ending June 30	Principal	Interest	Total
2004	$1,366,246.73	$1,243,083.82	$2,609,330.55
2005	1,383,433.32	1,180,144.25	2,563,577.57
2006	854,888.25	1,115,278.04	1,970,166.29
2007	899,261.85	1,073,561.87	1,972,823.72
2008	940,512.66	1,033,680.95	1,974,193.61
2009 – 2013	4,730,307.30	4,491,644.93	9,221,952.23
2014 – 2018	4,372,149.26	3,350,039.57	7,722,188.83
2019 – 2023	4,796,677.02	2,238,905.80	7,035,582.82
2024 – 2028	2,858,113.65	1,218,149.50	4,076,263.15
2029 – 2032	2,893,641.25	389,859.48	3,283,500.73
	$25,095,231.29	$17,334,348.21	$42,429,579.50

NOTE 9. UNRESTRICTED NET ASSETS

Unrestricted net assets include funds that have been designated or reserved for specific purposes. The unrestricted net assets are composed of the following:

	June 30, 2003	June 30, 2002
Working capital	$6,077,808.42	$6,174,147.73
Encumbrances	1,037,702.41	1,394,826.58
Designated fees	627,739.75	780,787.74
Auxiliaries	914,576.08	968,827.02
Quasi-endowment	9,551,289.90	6,514,492.80
Plant construction	2,832,757.89	3,477,996.12
Renewal and replacement of equipment	13,848,636.37	13,676,955.30
Debt retirement	1,092,999.58	1,054,021.80
Unreserved/undesignated	74,331.76	(6,619.62)
Total	$36,057,842.16	$34,035,435.47

NOTE 10. ENDOWMENTS

If a donor has not provided specific instructions to the university, state law permits the university to authorize for expenditure the net appreciation (realized and unrealized) of the investments of endowment funds. When administering its power to spend net appreciation, the university is required to consider the university's long-term and short-term needs, present and anticipated financial requirements, expected total return on its investments, price-level trends, and general economic conditions. Any net appreciation spent is required to be spent for the purposes for which the endowment was established.

The university's endowment and quasi-endowment assets are invested to produce only interest income. For the fiscal year ended June 30, 2003, the university's endowments and quasi-endowments earned interest income totaling $165,856.34. All of these earnings were expended by the university.

NOTE 11. PENSION PLANS

A. Defined Benefit Plan

Tennessee Consolidated Retirement System

Plan Description - The university contributes to the State Employees, Teachers, and Higher Education Employees Pension Plan (SETHEEPP), a cost-sharing, multiple-employer, defined benefit pension plan administered by the Tennessee Consolidated Retirement System (TCRS). TCRS provides retirement, death, and disability benefits as well as annual cost-of-living adjustments to plan members and their beneficiaries. Title 8, Chapters 34-37, *Tennessee Code Annotated*, establishes benefit provisions. State statutes are amended by the Tennessee General Assembly.

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for SETHEEPP. That report may be obtained by writing to the Tennessee Department of the Treasury, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, Tennessee 37243-0230, or by calling (615) 741-8202.

Funding Policy - Plan members are noncontributory. The university is required to contribute an actuarially determined rate. The current rate is 7.29% of annual covered payroll. Contribution requirements for the university are established and may be amended by the TCRS' Board of Trustees. The university's contributions to TCRS for the years ended June 30, 2003, 2002, and 2001 were $2,372,506.81, $1,904,373.30, and $1,817,069.99. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans (ORP)

Plan Description - The university contributes to three defined contribution plans: Teachers Insurance and Annuity Association–College Retirement Equities Fund (TIAA-CREF), Aetna Life Insurance and Annuity Company, and Variable Annuity Life Insurance Company (VALIC). These plans are administered by the Tennessee Department of the Treasury. Each plan provides retirement benefits to faculty and staff who are exempt from the overtime provisions of the Fair Labor Standards Act and who waive membership in the

TCRS. Benefits depend solely on amounts contributed to the plan plus investment earnings. Plan provisions are established by state statute in Title 8, Chapter 35, Part 4, *Tennessee Code Annotated.* State statutes are amended by the Tennessee General Assembly.

Funding Policy - Plan members are noncontributory. The university contributes an amount equal to 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. Contribution requirements are established and amended by state statute. The contribution made by the university to the plans was $5,872,612.05 for the year ended June 30, 2003, and $5,563,890.15 for the year ended June 30, 2002. Contributions met the requirements for each year.

NOTE 12. OTHER POST-EMPLOYMENT BENEFITS

The State of Tennessee administers a group health insurance program which provides post-employment health insurance benefits to eligible university retirees. This benefit is provided and administered by the State of Tennessee. The university assumes no liability for retiree health care programs. Information related to this plan is available at the statewide level in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

NOTE 13. CUMULATIVE EFFECTS OF CHANGES IN ACCOUNTING PRINCIPLE

During the year ended June 30, 2002, the university implemented GASB Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. As a result of this implementation, the university was required to make changes in certain accounting principles, specifically the (1) adoption of capitalization criteria of $100,000 and $50,000 for buildings and additions, respectively; (2) change in the method of capitalizing library holdings; (3) adoption of depreciation on capital assets; (4) recording of certain summer semester revenues between fiscal years rather than in the fiscal year in which the semester was predominantly conducted; and (5) reclassification of the U.S. government grants refundable amount as a liability. The cumulative effects of these changes on net assets are shown below:

Adoption of capitalization criteria for buildings and additions	($4,571,227.64)
Change in method of capitalizing library holdings	($37,490,305.35)
Adoption of depreciation on capital assets	($93,905,211.24)
Deferred revenue recognition	$1,020,193.48
Reclassification of U.S. government grants refundable	($7,132,829.18)

NOTE 14. INSURANCE-RELATED ACTIVITIES

The state purchases commercial insurance for real property losses above $5 million per year and surety bond coverage on the state's officials and employees. In the past three fiscal years, the state has had no claims filed with the commercial insurer. A designation for casualty losses in the amount of $3.271 million for incurred losses at June 30, 2003, was established in the state's general fund to provide for any property losses not covered by the commercial insurance.

At June 30, 2003, the scheduled coverage for the university was $415,075,500 for buildings and $100,405,272 for contents. At June 30, 2002, the scheduled coverage for the university was $430,010,700 for buildings and $104,047,100 for contents.

The state has set aside assets for claim settlement in an internal service fund, the Claims Award Fund. This fund services all claims for risk of loss to which the state is exposed, including general liability, automobile liability, professional malpractice, and workers' compensation. The university participates in the Claims Award Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on a percentage of the university's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of fiscal year-end to determine the fund liability and premium allocation. Since the university participates in the Claims Award Fund, it is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, *Tennessee Code Annotated*, Section 9-8-101 et seq. Liability for negligence of the university for bodily injury and property damage is limited to $300,000 per person and $1,000,000 per occurrence. The limits of liability under workers' compensation are set forth in *Tennessee Code Annotated,* Section 50-6-101 et seq. Claims are paid through the state's Claims Award Fund.

The state has also set aside assets in the Employee Group Insurance Fund, an internal service fund, to provide a program of health insurance coverage for the employees of the state with the risk retained by the state. The university participates in the Employee Group Insurance Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on estimates of the ultimate cost of claims that have been reported but not settled and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims.

The university also provides health insurance coverage for residents associated with the James H. Quillen College of Medicine with the risk retained by the university. At June 30, 2003, there were 257 participants.

The plan establishes claims liabilities based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. Participants have 90 days to file medical claims. The process used to compute claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed periodically using actuarial and statistical techniques to produce current estimates. Adjustments to claims liabilities are charged or credited to expense in the period in which they are made.

As discussed above, the university establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities during the past two years:

	2003	2002
Unpaid claims at beginning of year	$639,846.58	$831,763.51
Incurred claims, provision for insured events of the current year	2,001,857.83	1,029,444.76
Total incurred claims expenses	2,641,704.41	1,861,208.27
Payments	1,674,005.26	1,221,361.69
Total unpaid claims at end of year	$967,699.15	$639,846.58

NOTE 15. COMMITMENTS AND CONTINGENCIES

Sick Leave - The university records the cost of sick leave when paid. Generally, since sick leave (earned one day per month with unlimited accumulation) is paid only when an employee dies or is absent because of illness, injury, or related family death, there is no liability for sick leave at June 30. The dollar amount of unused sick leave was $39,688,499.89 at June 30, 2003, and $36,886,162.69 at June 30, 2002.

Operating Leases - The university has entered into various operating leases for buildings and equipment. Such leases will probably continue to be required. Expenses under operating leases for real property were $192,018.31 and for personal property were $135,695.28 for the year ended June 30, 2003. Comparative amounts for the year ended June 30, 2002, were $368,053.00 and $125,317.06. All operating leases are cancelable at the lessee's option.

Construction in Progress - At June 30, 2003, outstanding commitments under construction contracts totaled $1,403,501.82 for the Physical Activity Center, Clinical Education Building, Fossil Site Visitor Center, Forensic Pathology Renovations, and ADA Improvements projects, of which $158,675.65 will be funded by future state capital outlay appropriations.

Litigation - The university is involved in several lawsuits, none of which are expected to have a material effect on the accompanying financial statements.

NOTE 16. AFFILIATED ENTITIES NOT INCLUDED

The university is the sole beneficiary of the Medical Education Assistance Corporation (MEAC) and the East Tennessee State University Foundation. These private, nonprofit corporations are controlled by boards independent of the university. The financial records, investments, and other financial transactions are not handled by the university, and these amounts are not included in the university's financial statements. As reported in MEAC's most recently audited financial report, at June 30, 2003, the corporation's assets totaled $13,241,415, liabilities were $3,547,361, and the net assets amounted to $9,694,054. As reported in the foundation's most recently audited financial report, at June 30, 2003, the foundation's assets totaled $25,174,738, liabilities were $124,568, and the net assets amounted to $25,050,170.

NOTE 17. CHAIRS OF EXCELLENCE

The university had $18,391,567.78 on deposit at June 30, 2003, and $18,165,659.31 on deposit at June 30, 2002, with the State Treasurer for the university's Chairs of Excellence program. These funds are held in trust by the state and are not included in the financial statements.

NOTE 18. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The university's operating expenses by functional classification for the year ended June 30, 2003, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$66,464,283.05	$16,445,151.50	$13,430,443.79	$1,589,979.22	$ -	$97,929,857.56
Research	6,593,561.17	2,000,684.02	4,554,085.98	45,533.40	-	13,193,864.57
Public service	6,038,565.67	1,546,882.65	3,405,827.43	43,346.50	-	11,034,622.25
Academic support	9,511,889.06	2,669,874.48	4,113,588.92	375,370.27	-	16,670,722.73
Student services	6,481,127.97	2,048,329.62	3,745,021.19	1,288,390.02	-	13,562,868.80
Institutional support	9,222,456.37	3,028,932.72	370,403.94	165,382.15	-	12,787,175.18
Operation & maintenance of plant	5,229,342.64	2,126,262.11	8,192,938.80	1,356.94	-	15,549,900.49
Scholarships & fellowships	1,319.00	8,409.76	402,438.47	8,169,754.67	-	8,581,921.90
Auxiliary	1,276,002.52	287,551.85	4,540,152.58	85,644.20	-	6,189,351.15
Depreciation	-	-	-	-	8,191,364.67	8,191,364.67
Total	$110,818,547.45	$30,162,078.71	$42,754,901.10	$11,764,757.37	$8,191,364.67	$203,691,649.30

The university's operating expenses by functional classification for the year ended June 30, 2002, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$63,333,968.53	$14,005,395.94	$22,016,234.77	$1,272,067.16	$ -	$100,627,666.40
Research	6,358,735.60	1,682,395.94	3,934,616.19	61,746.45	-	12,037,494.18
Public service	5,603,335.00	1,348,286.98	3,323,368.20	71,453.05	-	10,346,443.23
Academic support	9,602,215.55	2,428,656.23	3,466,405.05	364,855.69	-	15,862,132.52
Student services	6,286,484.01	1,811,678.72	3,522,972.95	1,406,102.61	-	13,027,238.29
Institutional support	8,952,953.85	2,638,053.53	877,533.72	183,187.60	-	12,651,728.70
Operation & maintenance of plant	4,985,561.75	1,753,924.00	7,299,598.65	1,564.13	-	14,040,648.53
Scholarships & fellowships	2,667.00	12,081.04	327,181.70	6,399,030.49	-	6,740,960.23
Auxiliary	1,149,385.06	260,083.10	3,998,080.41	165,383.07	-	5,572,931.64
Depreciation	-	-	-	-	8,394,471.26	8,394,471.26
Total	$106,275,306.35	$25,940,555.48	$48,765,991.64	$9,925,390.25	$8,394,471.26	$199,301,714.98

NOTE 19. PRIOR-YEAR RESTATEMENTS

Due to changes in presentation made by the university for the year ended June 30, 2003, some reclassifications were made in the prior-year financial statements for comparative purposes. The LGIP deposit – capital projects was reclassified as noncurrent cash and cash equivalents. The TSSBA interest rate reserve, which was previously shown as deposit with trustee, was reclassified as prepaid expense. Also, the note disclosure for unrestricted net assets was changed to show all of the components rather than just the designated amounts.

In addition, the university understated the cumulative effect of a change in accounting principle by ($1,625,587.87) in its 2002 financial statements. The adoption of depreciation on capital assets has been restated at ($93,905,211.24) rather than ($92,279,623.37).